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House of Representatives

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Recommendations and summary report of the:

CREDIT RATING WORKING GROUP

Massachusetts House of Representatives

House Committee on Post Audit and Oversight
House Committee on Transportation
House Committee on Long Term Debt

Wednesday, 3 April 2002

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"The commonwealth may give, loan or pledge its credit only by a vote taken by the yeas and nays of two-thirds of each house of the general court present and voting thereon..."

Article LXXXIV,

Constitution of the Commonwealth of Massachusetts

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THE SPEAKER APPOINTS CREDIT RATING AGENCY WORKING GROUP

In late January 2002, the Honorable Thomas M. Finneran, Speaker of the House of Representatives, formed an ad hoc select committee of the Massachusetts House of Representatives known as the Credit Rating Working Group. This select committee or working group consisted of the House Committee on Post Audit and Oversight (HPAO), House Committee on Transportation, and House Committee on Long Term Debt. Throughout February 2002, this Credit Rating Working Group met with the three major credit rating agencies, as well as with the Office of the Treasurer and Receiver General and the Office of the Comptroller. All meetings were held in the HPAO Committee Chairman's office in Room 146. Following the series of seminars and presentations by analysts and selected state executives involved in the debt of the Commonwealth of Massachusetts, the Credit Rating Working Group held a public hearing on Tuesday, 5 March 2002 in Gardner Auditorium. The hearing took testimony from persons and representatives of: credit rating agencies, constitutional offices, independent authorities and agencies, and the Executive regarding the credit of the Commonwealth of Massachusetts. An agenda for the public hearings is attached. The volume of testimony made a second hearing necessary, which was held on Wednesday, 20 March 2002.

This report discusses recommendations and topics that were developed from dialogue between legislators, legislative and House committee staff, staff of the HPAO Bureau, credit rating agency managers and state debt managers. This dialogue took place at both the private meetings of the select committee and at the public hearings held at the Gardner Auditorium on Tuesday, 5 March 2002, and in Room B-1, both hearing rooms at the Massachusetts State House.[1]

Members of the Select Committee forming the Credit Rating Working Group are:

Members of the Credit Rating Working Group Select Committee

House committee on Post Audit and Oversight

Rep. James H. Fagan of Taunton, chairman
Rep. James E. Vallee of Franklin, vice chairman
Rep. Frank M. Hynes of Marshfield
Rep. Louis L. Kafka of Sharon
Rep. Geraldine Creedon of Brockton
Rep. Stephen P. LeDuc of Marlborough
Rep. Mark V. Falzone of Saugus
Rep. Thomas M. Stanley of Waltham
Rep. James M. Murphy of Weymouth
Rep. Robert S.Hargraves of Groton
Rep. John A. Locke of Wellesley

House committee on Long Term Debt and Capital Expenditures

Rep.Marie J. Parente of Milford, chairwoman
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Rep. David L. Flynn of Bridgewater
Rep. J. James Marzilli Jr. of Arlington
Rep. Jay R. Kaufman of Lexington
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Rep. Cheryl A. Rivera of Springfield
Rep. Thomas M. Stanley of Waltham
Rep. James M. Murphy of Weymouth
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Rep. Elizabeth A. Malia of Boston
Rep. Anthony Petruccelli of Boston
Rep. Elizabeth A. Poirier of North Attleborough
Rep. Viriato M. deMacedo of Plymouth

ACKNOWLEDGEMENTS

The Credit Rating Working Group met during the month of February with many experts in the field of debt finance. In March, many of the persons who so kindly gave of their time during the February sessions returned to offer testimony at two well-attended public hearings to further discuss the state's debt with House of Representatives Members, the Committee Staffs, and the staff of the House Post Audit and Oversight Bureau.

The effort and expertise of all of those offering explanation, illustration and counsel to the Members and staff of the Credit Rating Working Group are most appreciated. None of the work of this Group could have been accomplished without the contributions of the many talented experts who both instructed and testified on debt matters and credit ratings..

The Credit Rating Working Group thanks the Speaker, the Honorable Thomas M. Finneran, as well as the staff of the Speaker's Office for all their efforts, most particularly the chief policy advisor to the Speaker, the counsel to the Speaker, and the communications director.

And, too, the tri-committee Credit Rating Working Group thanks its individual members for their attentiveness, participation, and hard work on a most difficult and complex subject.

The Credit Rating Working Group particularly thanks: The representatives of the three primary credit rating agencies: Fitch Ratings, Moody's Investor Service, and Standard and Poor's; the Executive Office for Administration and Finance; the Office of the Treasurer and Receiver General of the Commonwealth of Massachusetts; the Office of the State Comptroller; the state Department of Education; the Massachusetts Convention Center Authority; the Massachusetts Port Authority; the Massachusetts Turnpike Authority; and the Federal Reserve Bank of Boston.

Recommendations

1. Develop a plan that restores structural balance to the state budget. (Pages 12-13).

2. Avoid whenever possible one-time "quick-fix" solutions and/or gimmicks. (Pages 13-15).

3. Utilize a portion of the tobacco settlement proceeds to leverage federal matching monies to Medicaid and future health costs and/or to continue some level of funding for both the stabilization fund and the pension fund in a time of depleted state revenue. (Pages 15-17).

4. Use utmost caution on increased state borrowing. (Page 9).

5. Avoid the issuance of "Tobacco Bonds" as a means to address the structural budget deficit. (Page 17).

6. Make any ongoing use of the stabilization fund subject to a two-thirds vote of the Legislature and require that the funds accessed be appropriated back to the stabilization fund over a four year period. (Page 18).

7. Require contribution to stabilization fund in all years with amendment to Chapter 29. Set appropriations at no more than 98 percent of the official revenue forecast and appropriate the remainder of said monies to the stabilization fund. (Page 18).

8. Establish a "Debt Avoidance Fund" that will be financed by revenues from capital gains, bonuses and stock options that exceed the historical average for those components of income tax revenue as established by the Legislature and the Department of Revenue. (Pages 18; 32).

9. No reduction in the Pension Fund's budget appropriation should occur without a comprehensive plan that achieves structural balance and addresses pension fund stability over the short and long terms. (Pages 19; 21-23).

10. A revised Pension Fund valuation, and an analysis of any proposal to alter the current pension-funding schedule, must be an essential part of any plan to restore structural balance to the Massachusetts budget. (Pages 19-23).

11. Avoid the issuance of any "fiscal recovery bonds" or the use of deficit financing. (Pages 14; 20; 23-24).

12. Require MassPort to reimburse the Commonwealth for the additional financing cost imposed as a result of the delay of its $105 million December 2002 CA/T payment. (Pages 25-27).

13. Require MassPort to advise and inform the Legislature in a timely fashion of any and all issues materially impacting the financial stability of the Authority. (Pages 26-27).

14. Review and determine the governing structure, autonomy and relationship to the Executive that should be imposed upon the Massachusetts Turnpike Authority and other agencies and authorities of the Commonwealth. (Pages 28-29).

15. Create a select task force on the School Building Assistance program to review the report and recommendations of the Executive Office of Administration and Finance on "Reconstructing the School Building Assistance Program," and to issue findings on the feasibility of a capital pooling for school building projects. (Pages 29-31).

16. Create a Legislative Fiscal Bureau similar to legislative budget offices in other states such as Wisconsin's Fiscal Bureau or on the national level, the Congressional Budget Office. The Bureau will be a non-partisan entity that will assist the House and Senate Committee on Ways & Means with certain functions which shall include (1) estimating state revenues; (2) analyzing and evaluating cost/benefit of state programs; (3) monitoring state agencies' budgets and programs; and, (4) evaluating legislative proposals for fiscal effect. (Pages 32-33).

17. The House & Senate Committees on Ways & Means, the Executive Office of Administration and Finance, and the Department of Revenue should jointly conduct a study that will recommend methods or systems that will allow the Department of Revenue and the Legislative Fiscal Bureau to segment and project components of the income tax revenue stream among capital gains, bonuses and stock options. In addition, the above study will also recommend methods or systems that will allow tax revenue estimates to be less reliant on national economic trends and be more clearly focused on state economic-sector analysis. (Pages 32-33).

TOPICS

1. CREDIT RATINGS

Definitions and Standards

Credit ratings are simply an opinion regarding an entity's ability to repay its debt. It is not a recommendation to buy, sell, or hold on to a security. Ratings are seals of approval for state's creditworthiness by objective analysts. [2] Moody's Investors Service defines a credit rating as "an independent, objective opinion about credit risk...Judgment of the investment quality of a long-term obligation issued by a state or one of its subdivisions...Assessment of the ability and willingness of an issuer to make full and timely payments of amounts due on the security over its life."[3] An outlook, in contrast, is to provide investors with a sense of where an entity may be going beyond its rating over a medium-term horizon of 12-18 months. A "Negative Outlook could indicate credit has undergone stress, but [the entity] **is in the process of implementing a strategic plan that has a reasonable chance of restoring stability**."[4] (*Emphasis added.*)

A rating is "typically assigned to a specific series of bonds or debt instrument, not the state." For example, Moody's refers to its assigned ratings in this way: " we have affirmed our Aa2 rating on the Commonwealth's outstanding general obligation bonds which means that all of the general obligation bonds carry the Aa2 rating."[5] The three primary rating agencies - Fitch Ratings, Moody's Investors Service, and Standard & Poor's - each use a specific set of rating factors in determining credit ratings. Common factors include (1) the current and historical economic situation, (2) management factors, (3) the level of indebtedness, and (4) financial strengths and weaknesses.

Massachusetts' Strengths and Weaknesses

The Commonwealth's major strengths in the eyes of the credit rating agencies include: the sizeable (at present) stabilization fund; the thus-far conservative approach to spending tobacco settlement funds; constrained spending on recurring expenses during the most recent economic boom; capital projects funded, in part, with cash, and the "accelerated schedule for [the elimination of] un-funded pension liability."[6]

The Commonwealth's major weaknesses in the eyes of the credit rating agencies include: one of the heaviest tax-supported debt burdens in the country whether measured as a percent of personal income or as a per-capita debt burden; as well as the cost of the ongoing Central Artery/Tunnel (CA/T) Project together with uncertainty as to how any further CA/T cost overruns would be funded. Fitch Ratings also pointed to the lack of a consensus revenue forecast for FY2002 as a weakness, and questioned as well the Commonwealth's ability to absorb the lowering of the personal income tax rate.[7]

Massachusetts' current state debt to personal income ratio is high at "about 9 percent" while New York State debt to personal income ratio is "about 6 percent," the analyst for Fitch Ratings advised. Generally, states with decentralized governments (unlike Massachusetts) maintain personal income to state debt ratios of approximately 3 percent of personal income. The Credit Rating Working Group was cautioned that a personal income debt ratio higher than 10 percent would cause the debt service payments to erode and impair the operating budget of the Commonwealth. Moody's also pointed out that while Massachusetts has a capital cap, this is not a "meaningful constraint," because the Commonwealth has a long history of issuing debt outside of the cap.[8]

Massachusetts' Ratings

Moody's currently rates Massachusetts General Obligation bonds at Aa2 with a negative outlook, classifying this as **an average rating**. Thirteen other states share that rating, while nineteen fall in the higher categories of Aaa or Aa1.[9] Fitch Ratings rates Massachusetts General Obligation bonds at AA-, which they classified as **a good rating** but indicated that **most states have a higher rating.** Standard & Poor's currently rates

Massachusetts General Obligation bonds at AA-, and noted that **45-46 states are in the AA range or higher.**

The rating agencies all emphasized that they do not encourage ratings as a reason to take a particular action or not to take a particular action in government; rather, actions should be based on what is appropriate for the state or municipality. While rating agencies do not comment or recommend particular policies, they all advocated for the broad goal of a structurally balanced budget.

State by State Comparison

As a service to its clients, Standard and Poor's released their State of the States report on March 5, 2002. This release date was coincident with the House select committee on Credit Rating's public hearing at the State House. The last Standard and Poor's State of the States report was released in October of 2001. Since the October report, the states have seen even weaker revenues than were previously estimated. Four states (New Jersey, Tennessee, Wisconsin, and Colorado) are now on Credit Watch with Negative Implications; three others (California, Indiana, and Kentucky) now have negative outlooks; and two states' outlooks (Massachusetts and Illinois) went from positive to stable.[10]

The State of the States report asserts that conservative revenue forecasting and formalized reserve policies are helping some states. Other states are reducing their spending and workforce with the primary tool being spending reductions. Some states have opted to roll back tax reductions, have implemented targeted fee increases or other minor tax or revenue measures, broadened the tax base supporting a specific tax, and/or have raised the tobacco tax, according to the report. Florida delayed its intangible tax reduction until 2004 and Maryland is considering deferring the personal income tax reductions. Some states also have mechanisms in their constitutions for automatic solutions if reserves/ revenues fall below a certain level, according to the Standard and Poor's report.

Investor Perception

States themselves are not the primary "users" of a credit rating; rather, investors are a credit rating agency's principal audience. Investor perception of a state's fiscal health is determined in large part by a state's credit ratings. Thus, a good credit rating attracts quality investors. Good credit ratings also translate into favorable interest rates for a state's borrowing. In addition to investors, other important and regular users of public finance credit ratings are the communications media. In conjunction with the rating agency comments, media comments influence investor perceptions and consequent actions. That is, the more favorable are the reports of credit rating agencies and the communication of those favorable reports, the more investors tend to buy the solidly rated public finance securities of a state or municipality.

Ratings also matter if investors panic and a condition known as "flight to quality" occurs, Fitch Ratings said during the Credit Rating Public Hearing. Bond buyers tend to be conservative investors searching for stability and prudence in public financial management, the credit rating panel generally agreed.[11]

2. CREDIT RATINGS AND INTEREST RATES ON STATE BORROWING

Legislators were particularly interested in the relationship between a state's credit rating and the rate of interest assigned to an issue. At both the private seminars with credit rating agencies and at the public hearing on 5 March, House Members asked about that relationship. At the public hearing the credit rating agencies stated that credit ratings are not the sole factor in determining interest rates for a state's debt, but they are important.[12] Ratings, like it or not, are a seal of approval.[13]

Current interest rates are very low and that has helped Massachusetts "refund" a large part of its more expensive older debt. "Credit spreads" are low between various public debt issuers because interest rates are extremely low, the Deputy Treasurer for Debt Management recently advised members of the Credit Rating Working Group.[14] At the same time, the State Treasurer and the rating agencies concurred that if Massachusetts acts with alacrity and prudence to close the structural gap between reduced revenue and its current unsustainable expenses with a thoughtful plan, "we will make our debt offering more attractive to both credit rating agencies and that therefore makes [Massachusetts] more attractive to investors."[15]

Standard & Poor's indicated that bond prices depend on the market, interest rates, etc., but that generally speaking, **if a bond rating decreases, the costs to the state increase.**[16] According to the Deputy Treasurer for Debt Management, for example, a reduction of a AA rating to an A will usually result in an increase of 25 basis points (each basis point is 1/100 of 1 percent). This could increase the cost of financing the Commonwealth's capital plan by $40 to $45 million. Likewise, a reduction to BBB from A could add approximately $120 million to finance costs.[17]

As noted by a Massachusetts-based bond fund: The credit quality of municipal issuers overall held relatively steady during 2001, with credit upgrades exceeding downgrades throughout the year. That said, there were some signs of deterioration during the final months of the year. That's when Moody's Investors Service downgraded the credit outlook, but not the credit rating of more than a dozen states. While most states were confronted with the twin challenges of sharply declining revenues and rising expenditures, those that were dependent on tourism, the technology industry and manufacturing were particularly hard hit by the economic slump and the events of September 11. In a related development, municipal bonds backed by airports and airlines also experienced credit trends due to the decline in travel after the terrorist attacks.[18]

3. Rating Fundamentals

Long-term Planning Creates Stability

All of the credit rating agencies told the select House Committee on Credit Rating that they look for a realistic long-term plan to achieve stability.[19] The credit rating agencies stressed that they do not take a position on specific policy decisions; however, they equally stressed the importance of having any and all policy decisions regarding revenue and expenditures made in the context of a comprehensive plan. A plan includes a move toward a "structurally balanced budget," a term used by all three rating agencies and defined by Moody's as a budget in which recurring revenues equal recurring expenditures.[20]

While one-time revenue sources ... are all deemed feasible options ... the credit rating agencies stressed that any such one-time infusions must be incorporated into a broader plan to bring the budget back into structural balance.

If fiscal goals are not immediately attainable, the rating agencies wish to see a longer-term strategy to reach those goals. While one-time revenue sources such as infusions from the stabilization fund, borrowing against tobacco settlement funds, and postponement of the accelerated state pension funding schedule payments are all deemed feasible options to close the budget gap, the credit rating agencies stressed that any such one-time infusions must be incorporated into a broader plan to bring the budget back into structural balance. Credit rating agencies view it as problematic when states find themselves continually searching for one-time stop-gaps to fund ongoing spending levels that outstrip recurring revenues.

Credit Ratings: Beware of Gimmicks and Quick Fixes

All of the rating agencies stressed long-term thoughtful solutions to structural budget problems and warned legislators to beware of gimmicks when attempting to restore structural balance – matching recurring revenues with recurring expenses. Moody's Investors Service advised that the rating agency "is interested in seeing a plan to achieve long term stability" and that Moody's "wants to see solutions that stay away from a one time fix."[21] Similarly, the deputy treasurer for debt management in the Office of the Treasurer and Receiver General specifically warned that any "fanciful schemes" to temporarily "plug the holes in a structural budget balance" would hurt Massachusetts in the view of credit rating analysts.

Although not specifically mentioned as gimmicks, all of the rating agencies cautioned against viewing a "securitization" or creation of so-called "tobacco bonds" as an easy means to obtain quick cash. Often the "quick cash" was necessary to plug gaping holes in other states' operating budgets. The "tobacco bonds" are "securitized" from monies obtained by the 1998 Tobacco Settlement (a negotiated deal between 46 states and some municipalities and large tobacco product companies).[22] (See Section on Tobacco Bonds below.)

Credit rating agencies do not make "policy" statements. Rather, the actions of a public entity (Massachusetts, for example) are evaluated by the agency which then offers its opinion and analysis to investors regarding a public entity's creditworthiness. Thus, the credit raters offer only an analysis of the utilization of tobacco bonds.

Moody's Investor Service has altered its view of tobacco bonds:

> In prior years tobacco bonds were used by several states as a way of shifting the risk to investors, with the risk being variability in those future payments (largely due to consumption patterns). The proceeds were then used to create an endowment or to fund various special programs. This year several states have proposed using tobacco bonds as a cash infusion to fill a budget gap. Used in this way, we view these types of bonds as a form of deficit financing. Using bonds for this purpose limits a state's future financial flexibility. This is because the bond proceeds are used upfront, and future payments are restricted for debt service on those bonds. In many cases, states have limited, practical alternatives for filling their budget gap, and in such cases, we think tobacco bonds can be part of a reasonable solution, if they are part of a strategy to restore structural balance to the budget.[23]

Fitch Ratings does not consider tobacco bonds "gimmicks" but states that "they do represent a one time revenue as opposed to the receipt of a revenue flow on an annual basis." Fitch Ratings questions the wisdom of using a long-term liability (tobacco bond) to solve a short-term financial problem (budget gap) noting " that it was not necessarily wise to set up a 25-30 year liability if the proceeds were to be used to fund a one to two year deficit."[24]

Nonetheless, the tobacco settlement monies are viewed as an asset to the states. Standard and Poor's recognized this and stated that a state can make use of these monies to increase its budgetary flexibility, which S&P views positively while pointing out that tobacco bonds and the cash from the tobacco settlement are "one of a number of sources of flexibility (along with various reserves, pension funding assumptions, shifts of capital purchases from pay-as-you-go to bond funding) which it is legitimate to use when 'it rains'. They are a legitimate option to bridge time and funding gaps to get back to balanced operations."[25]

The primary concern regarding the "securitization" of all or some of the projected tobacco funds is the long-term viability of the settlement payments. Those tobacco settlement funds are dependent upon the future fiscal health of the tobacco companies. Should the tobacco companies be unable to pay the terms of the (1998) settlement, any tobacco bond repayment schedule is jeopardized because the collateral (tobacco company payments) is interrupted and/or unavailable. A state would be indirectly but certainly liable for repayment. This risk factor would be worked into a tobacco bonds price when and if it was offered by a state. Therefore, the up front cash from a tobacco bond would be less than the sum of the monies promised to a state in the settlement terms. The Tobacco Bond price and interest would **not** be as favorable as Massachusetts general obligation bond sales price and rate of return. The tax exempt status of the Tobacco Bond is open to interpretation, according to various testimony heard by, and materials reviewed by, the Credit Rating Working Group.

4. SPECIFIC ISSUES

I. TOBACCO BONDS

The Origin of Tobacco Bonds

Tobacco bonds were introduced shortly after the national tobacco settlement with the states. Several investment houses – Bear Stearns, Merrill Lynch & Company, Goldman Sachs, PaineWebber, Inc. – are "pitching" these promised tobacco funds as new securities. In the first full week of March, the Governor of Rhode Island proposed to the R.I. General Assembly that the state's tobacco monies be indebted to produce much needed cash. The proposal was met with skepticism.[26] In particular, the Providence Journal reported that the R.I. Governor's proposal "did not completely jibe with the warnings that Wisconsin lawmakers received" when that state embraced "tobacco bonds" recently.[27]

Tobacco Bonds

The so-called "Tobacco Settlement" was reached in part to mitigate the states' future health care costs and obligations as they were incurred due to individuals' use of tobacco products and the consequent deterioration of their health.[28] In addition to the states, the Tobacco Settlement included several U.S. cities and U.S. territories, county governments and the District of Columbia.[29] The money had become a tempting target for budget balancers short on cash; however, **today's windfall is tomorrow's unwelcome obligation**.

As state budgets experience a revenue shortfall, the use of the tobacco settlement money both present and future, is a tempting means to achieve a balanced budget. To obtain more cash that is annually available, some states (Wisconsin, Louisiana, for example), a California city (San Diego), and other political sub-divisions that were part of the Settlement created debt securities (bonds) out of the cash stream promised to them over time by the Tobacco companies that participated in the deal.[30] Several of the presenters specifically cautioned against so-called Tobacco Bonds as budget balancing devices because these bonds are one-time cash infusions. [see earlier section of this report sub-titled: "Credit Ratings: Beware of Gimmicks"] Nonetheless, these "tobacco bonds" were also recognized as state assets that could be used for "some purposes." The question is, what is the most prudent long-term use of the Tobacco Settlement money. A few states (Tennessee, Wisconsin, Iowa, and now Rhode Island's Governor is suggesting it to the state Assembly) have issued Tobacco bonds to either plug a shortfall or to get the bulk of their money now. Both actions are viewed with suspicion. The recent S&P State of the States report notes that two of the states with Tobacco bonds, (Tennessee and Wisconsin) are on Credit Watch with Negative Implications. Tennessee, Standard and

Poor's noted in its State of the States report, has used one-time revenues for the past four fiscal years, along with spending cuts, to balance its budgets.[31] Tennessee was the first state to issue bonds collateralized upon that state's anticipated Tobacco settlement.[32]

'Tennessee... has used one-time revenues for the past four fiscal years, along with spending cuts, to balance its budgets.'

In addition, the Tobacco bonds carry a certain risk, both credit rating analysts and state debt managers told the Select Committee on Credit Rating, because the revenues to pay the 1998 settlement were based on the tobacco companies continuing, profitably, in the business of making and selling tobacco products. However, there is a logical problem with this premise. The settlement itself suggested an active public health campaign to persuade people to stop smoking. The smoking habit is precisely where the tobacco companies get their money, and paradoxically if the "stop smoking" public health campaign is successful, the tobacco settlement money to the states is in jeopardy. That is bad news for both Tobacco Bond investors and for the states that issue Tobacco Bonds.

If tobacco company revenues fall, so do the proceeds to the states. Tobacco company revenue shortfalls increase the investor's risk for a possible default on the Tobacco bonds. That too is bad news for the states issuing Tobacco Bonds because if the bonds' revenues become unstable or nonexistent, the issuing states may have to guarantee the remainder of the repayment. That guarantee would hurt a state's credit rating because it is hard to quantify the future obligation and the consequent risk to investors.[33]

RECOMMENDATION:

The Working Group recommends that the Legislature avoid the issuance of "Tobacco Bonds" as means to address the structural budget deficit.

II. COMMONWEALTH STABILIZATION FUND

Re-Capitalize the Stabilization Fund

All of the major credit agencies recognize the Commonwealth Stabilization Fund to be a major Massachusetts asset. While it is fortunate and forward-looking that the state has this asset, depletion of it against an unknown financial future is a concern. Indeed, one credit rating agency witness among the panel told the Credit Working Group that her agency had some concern about the outflow of cash from the Stabilization Fund. Imprudent use of the Stabilization Fund may cause it to be used in lieu of a more necessary adjustment on expenses.[34]

The State of Minnesota is developing a plan to restore reserves in future fiscal years. This action is viewed positively from a credit standpoint, according to Standard and Poor's report. The report further notes that a Mississippi statute requires budgeted appropriations to be less than 98 percent of official revenue forecast with a percentage remainder of the appropriation deposited to that state's stabilization account. Similarly, "The State of Missouri makes one half of its stabilization fund available in a given year. In order to access the funds, a two-thirds vote of the Legislature is required. Thereafter, only one-third of the amount transferred or expended from the budget reserve fund for budget stabilization purposes during any fiscal year, together with interest that would otherwise have been earned on such amount, shall stand appropriated to the budget reserve fund during each of the next three fiscal years until such time as the fund has been replenished"[35] These actions by the above states are viewed as being fiscally prudent and credit positive.

RECOMMENDATION

Therefore, the Working Group recommends the following:

(1) Any ongoing use of the stabilization fund be subject to a two-thirds vote of the Legislature and that the funds accessed be appropriated back to the stabilization fund over a four year period;

(2) For years where the Commonwealth does not experience a surplus, the Legislature set appropriations at less than 98percent of the official revenue forecast and the remainder to be appropriated to the stabilization fund;

(3) The Legislature establish a "Debt Avoidance Fund" that will be financed by revenues from capital gains, bonuses and stock options that exceed the historical average for those components of personal income as established by the Legislature and the Department of Revenue.

III. PENSION FUNDING

Avoid Retreat from Accelerated Pension Schedule

Debt managers and credit analysts recommend that no reduction in the pension repayment schedule budget appropriation occur without a comprehensive plan that achieves overall fiscal balance and addresses pension stability over the short and long terms.

Also a revised valuation and analysis of any proposal to alter the current pension-funding schedule is an essential part of any plan to restore structural balance to the Massachusetts budget.

Without an accurate, revised valuation and an analysis of the long-term effects of this appropriation deceleration, the move is risky and is not part of a realistic comprehensive fiscal plan to provide structural balance. **Without being part of a**

comprehensive fiscal recovery plan, extending the pension schedule is tantamount to deficit financing.[36]

One option suggested to the Legislature for closing the deficit for FY02 and beyond is to extend the pension schedule established under G.L. c. 32, §22C. Under the provisions of that statute, the Commonwealth's un-funded pension liability will be reduced to zero by June 30, 2018.[37] This schedule reflects an acceleration of the initial schedule that set 2028 as the date for full funding. The suggested option retreats from the position of accelerated repayment.

Under the present funding scheme, Commonwealth appropriations are set pursuant to actuarial analysis predicated upon the 2018 full funding date. As such, the Legislature appropriates an amount sufficient to pay the current costs of retirement benefits and an amount above the actual cost of benefits that is intended to fund the Commonwealth's future pension liability. This appropriation and the investment earnings of the Pension Reserves Investment Trust (PRIT) Fund, combined, are calculated to fully fund the liability by June 30, 2018.

The acceleration of the schedule from 2028 to 2018 was accomplished through increased legislative appropriations and above average returns on the PRIT Fund's investments. The Commonwealth was able to increase annual appropriations because of significant yearly surpluses in the general fund. Similarly, the PRIT Fund, as recently as 2000, enjoyed a rate of investment fund return in excess of 16 percent.

The factors that made this possible are not present today. For FY 98, 99 and 2000 approximately $441 million was transferred from the State Employees' and State Teachers' accounts in the PRIT Fund to pay retirement benefits.[38] In addition to the diminishing appropriation, in real dollars and as a percentage of the actual retirement benefits, the PRIT Fund has experienced losses for two consecutive years.[39] In 2001, for example, the PRIT Fund lost 5.3 percent on its investments. The investment losses alone would require that the Legislature increase the yearly appropriation in order to maintain the 2018 target date. When diminished appropriations are added to fund losses, the 2018 statutory mandate is not attainable. As such, the next valuation of the system performed by PERAC will show that in order to sustain the 2018 full funding schedule, the

Legislature will have to significantly increase appropriations to the Commonwealth's Pension Liability Fund in the years to come.

Commensurate with the charge to the Working Group, any deceleration of the pension schedule back to 2028 must be analyzed from the perspective of the credit rating agencies. Moody's Investment Services, Standard & Poor's and Fitch Ratings have all stated that a deceleration of the schedule to 2028 would be viewed as "credit neutral."[40] The agencies would not take a negative ratings outlook if the Legislature were to return the schedule to where it had been originally: 2028.[41] The agencies stated that the acceleration to 2018 was made possible by fiscal and economic conditions that may never again occur.[42] Therefore, a return to a more "realistic" fiscal environment would justify the return to the original schedule.[43]

All credit rating statements that were made by the agencies, including the pension-funding schedule, were tempered by a belief that any budgetary decisions must be made as part of a comprehensive plan.[44]

All credit rating statements that were made by the agencies, including the pension-funding schedule, were tempered by a belief that any budgetary decisions must be made as part of a comprehensive plan.[45] Any recourse to one-time revenue sources must be followed with a plan that seeks to achieve structural balance in the budget as the final goal. Therefore, while the deceleration of the schedule may not, in and of itself, be objectionable from a credit rating perspective, the deceleration must be combined with a comprehensive plan that achieves overall fiscal balance and addresses pension stability over the short and long terms.

When viewed through the prism of a comprehensive plan, the proposed reduction in pension fund appropriation for the remainder of FY02 is flawed. The $912 million appropriation that was approved for FY02 has already been paid out to retirees this year.[46] In fact, **as has been the case since FY98, the Pension Reserves Investment Management (PRIM) Board will have to liquidate approximately $500 million in**

assets from the PRIT Fund in order to meet benefit payments for FY02.[47] A further reduction in the appropriation in the amount of $130 million will have to be met with a further liquidation of assets of the State Employees' and State Teachers' accounts within the PRIT Fund. Without an accurate, revised valuation and an analysis of the long-term effects of this appropriation deceleration, the move is risky and is not part of a comprehensive fiscal plan to provide structural balance.

As stated earlier, without being part of a comprehensive fiscal recovery plan, extending the pension schedule is tantamount to deficit financing.[48] **By reducing appropriations and delaying full funding for ten years, the Legislature in effect will be borrowing from the assets of the PRIT Fund to fund yearly operating expenses in the form of current retirement benefits**. The continued borrowing will exacerbate the present gap between the assets of the PRIT Fund and the amount necessary to achieve full funding. Without significant appropriations or above average returns on investments, the 2028 schedule may be unattainable.

Similarly, the recent early retirement bill and pending layoffs, if necessary, will "significantly increase the liabilities to the fund."[49] These two actions will increase the yearly liability to the pension funds. As noted, **the current appropriation is insufficient to meet the present obligations of the system.** This shortfall causes PRIM to liquidate PRIT held funds. With an additional 5000 employees receiving retirement benefits and an unspecified number being eligible for c. 32, §10 benefits should the Commonwealth layoff employees, the current yearly cost will be greatly increased.

A confluence of events threatens to undermine the progress made over the past ten years to fully fund the pension system by 2018 or 2028. A persistent reduction in the yearly governmental appropriation, increasing yearly liabilities, a negative short-term investment performance, and increasing liquidation of PRIT assets all serve to strain the Commonwealth's ability to fully fund the system by 2028.

Therefore, no reduction in the budget appropriation should occur without a comprehensive plan that achieves overall fiscal balance and addresses pension stability over the short and long terms.

RECOMMENDATION:

Therefore, the Committee recommends the following:

(1) No reduction in the budget appropriation should occur without a comprehensive plan that achieves overall fiscal balance and addresses pension stability over the short and long terms.

(2) A revised valuation and analysis of any proposal to alter the current pension-funding schedule must be an essential part of any plan to restore structural balance to the Massachusetts budget.

IV. DEFICIT FINANCING

"Fiscal Recovery Bonds"

Deficit financing was a financial vehicle that Massachusetts utilized in its last major recession and consequent collapse of state revenues; the late 1980s and early 1990s, the end of the so-called "Massachusetts Miracle." Deficit financing is viewed as a desperate debt tactic. **One rating agent described deficit financing as "sending a (well-understood) message to investors: 'This is a problem that can't be fixed.'"**[50] All rating agencies warned against that investor message. Similarly, the state Treasurer's office said that perfect timing regarding the spending "down" of the Stabilization Fund was a nonsensical notion because no one could predict the precise end of the recession or of the return of, or "uptick" in, state revenues. If, however, the stabilization fund were exhausted, and further spending was necessary, and the revenue to support that spending was non-existent, (so-called deficit financing) certain debt vehicles are more appropriate than others. Straight General Obligation debt is the cheapest way to proceed, where tobacco bonds would be priced higher than the GO bond because of the source of the repayment (tobacco companies) to investors. Pension Obligation Bonds were not good deficit financing vehicles, the Office of the State Treasurer stated.

Deficit financing creates unforeseen problems. For example, the state Comptroller noted that cash flow considerations in the early 1990s caused the state to restructure its repayment of the debt incurred by the deficit financing measures of the late 1980s and early 1990s. That restructured payment cost more in interest but was necessary to repair and restore the state's cash flow. That repayment authorized by Chapter 5 of the Acts of 1992 is still being paid off, according to the State Comptroller.[51]

The alternative to deficit spending is revenue raising and expense reduction. On the latter point, at least one rating agency analyst that spoke to the tri-committee working group noted that "some people do not consider Massachusetts a high tax state" explaining that the "high tax" moniker was often the result of inappropriate comparison between states. Utah and Florida as comparisons, for example, make Massachusetts appear "high tax" but the comparisons are badly chosen. At the same time, items on the expense side also must be weighed. School Building Assistance for new school construction in Massachusetts cities and towns is extremely generous with one rating agency stating that "In New Jersey if they (municipalities) can get 18 percent (state) building assistance they are dancing in the streets."[52] In regard to analyzing expenses, one credit rating analyst commented that the decentralized human service agencies are difficult to assess in terms of costs and management. That analyst noted that the old institutional model was easy to assess: "it was a geographically based cost center, here is what it is, this is its (client) population, here is what you get."[53]

Recommendation:

Therefore, the Working Group recommends the following:

(1) That the Legislature avoid the issuance of any fiscal recovery bonds or deficit financing.

V. CENTRAL ARTERY/ TUNNEL (CA/T)

Central Artery/Tunnel Project (CA/T)

At the first public hearing of the House Select Committee, Moody's Investors Service stated that although the CA/T Project is an ongoing concern, this concern is somewhat mitigated by the fact that all of the Project's major construction contracts have been awarded. The Commonwealth has signaled to the investment community that it is committed to completing the project on schedule with the resources at hand, according to Moody's.[54] Standard & Poor's views the CA/T as a long-term concern, placing considerable pressure on state resources.[55] S&P pointed out that it is unclear how any potential further cost overruns will be funded, and who would ultimately be responsible. Although S&P thinks that the project will be completed, it is mindful that the other 350 communities in the Commonwealth may be shortchanged.[56]

At the Credit Rating Working Group's (CRWG) public hearing on March 5, 2002, a CRWG co-chairman asked each of the representatives from the credit rating agencies as well as Massachusetts Turnpike Authority officials if they would affirm that the present $14.475 billion CA/T project cost would hold.[57] No one ventured to affirm the amount. On the Saturday following the Credit Rating Working Group's public hearing, both the Boston Globe and the Boston Herald reported an additional price increase of $162 million.[58] The Turnpike Authority attributed this cost change to an "accounting shift" required by the US Department of Transportation Office of the Inspector General (DOTIG) in order for the Project to receive federal approval of its October 2001 finance plan and to access remaining federal funding. As a condition of approval, the DOTIG required that total project costs reflect $150 million in insurance premiums that the Project intended to pay with interest earned on reserves on its Owner Controlled Insurance Program (OCIP). The DOTIG also stipulated that the project account for the estimated $12 million cost of leasing back its headquarters at 185 Kneeland Street. Since the Project plans to pay for this lease cost with contingency funds, the net increase of these adjustments brings total Project costs to $14.625 billion.[59]

Massachusetts Port Authority (MassPort)

MassPort's bond ratings do not directly affect the Commonwealth's ratings.[60] According to MassPort's testimony at the Credit Rating Working Group public hearing on March 20, 2002, MassPort's credit rating has historically been among the top of Port Authorities throughout the country, and still is, according to testimony. According to a UBS Paine Webber report on the municipal bond market and the outlook of airport operations, Logan Airport remains among the strongest airports in the nation from a credit perspective with "a large and diverse portfolio of air carriers" and "exceptional airport control facilities."[61] Following September 11, MassPort implemented a fiscal recovery plan that significantly cut its operating and capital budgets. Staff levels were trimmed by 15 percent and many new capital projects have been postponed. MassPort also raised airport parking rates and tolls at the Tobin Bridge to bolster revenues. The report concludes that these austerity measures should make MassPort better positioned for the future as airline activity slowly rebuilds. MassPort officials anticipate that this process may take up to three years.

In February, Moody's affirmed the AAA bond rating on general revenue bonds with a negative outlook, and affirmed the A2 rating on passenger facility bonds with a negative outlook. Standard & Poor's dropped MassPort's credit rating on March 1st from AA- to A+, the smallest possible downgrade.[62] According to MassPort, S&P said they could not currently justify an AA rating for any airport given the industry climate.[63] Fitch has a "rating watch negative" on MassPort bonds.[64]

MassPort was scheduled in 1997 to contribute a total of $300 million toward the (CA/T) project, and was directed to contribute an additional $65 million in 2000. That $65 million was paid. According to the Office of the State Treasurer, MassPort has paid $95 million of its obligation, plus the aforementioned $65 million for a total of $160 million paid. An additional $105 million is due in December 2002, as well as $50 million in each of the following two Decembers.

The CA/T Project was given special permission to spend this contribution prior to MassPort's actually paying it, in order to maintain adequate cash flows during the project's peak construction years. The Commonwealth has served as the cash intermediary, paying the CA/T in advance and over time receiving reimbursement from MassPort. The Commonwealth has bonding authorization if necessary to pay for this cash gap.

At the Credit Rating Working Group public hearing on 20 March 2002, MassPort's Director of Administration and Finance confirmed that the agency has in fact postponed its December 2002 payment of $105 million. MassPort worked out an agreement with the Executive Office for Administration and Finance and the State Treasurer to make this payment in the summer of 2003. MassPort hopes to be in better financial standing by that time, and thus be able to receive a more favorable rating for the bonds that it will issue to make these Project contributions. MassPort officials emphasized, however, that they remain committed to meeting their CA/T project responsibilities.

The Commonwealth has agreed to adjust its cash flow projections to allow for this delay. By agreeing to do this, however, the Commonwealth will be forced, itself, to access the bond market on a short-term basis.[65] The short-term borrowing will result in approximately $1 million in financing costs to the Commonwealth.[66]

RECOMMENDATION:

Therefore, the Working Group recommends the following:

(1) MassPort should be required to bear the additional financing cost to the Commonwealth as a result of the delay of its December 2002 payment.

(2) MassPort shall advise and inform the Legislature in a timely fashion of any and all issues involving the health of the authority.

Massachusetts Turnpike Authority (MassPike)

Fitch Ratings placed the Massachusetts Turnpike Authority (MTA) on a "rating watch negative" because of the October 30, 2001 MTA board vote to delay toll increases on the Metropolitan Highway System and at the harbor crossings, which cost the MTA $30 million in foregone revenue. Fitch remains concerned that toll rates must go up in order to meet its CA/T project debt payments, and the MTA's ongoing management issues have further eroded this position. In November 2001, MTA officials proposed alternative revenue scenarios intended to mitigate the toll delay. However, the Fitch analyst stated at the March 5th CRWG hearing that she was never presented with the MTA's alternative plan.[67]

Moody's stated that their analysts were presented with the alternative plan; nonetheless, they felt that the alternative plan being offered by the Pike had weak provisions, offering one-time measures to bridge the revenue gap.[68] Moody's therefore placed the Turnpike on a negative credit watch. Moody's also said that the Turnpike's ratings or concerns will not affect the Commonwealth's ratings.

The Massachusetts Turnpike Authority and the Massachusetts Port Authority issue their own bonds which are rated separately from the Commonwealth's credit rating; however, there is an understanding from the credit rating agencies' viewpoint that should any of the Commonwealth's authorities find themselves unable to make payments, the Commonwealth would likely have to step in and assume the obligations created by the respective entities.[69]

Massachusetts Turnpike Authority debt totals $2 billion for the Metropolitan Highway System and $260 million for the Western Turnpike. The Authority has an additional $380 million in payments for the Central Artery/Tunnel Project.

The ongoing legal dispute concerning the MassPike's board membership has a direct negative effect upon the bond rating of the authority. In assessing the rating of an entity, all of the rating agencies stated that the "management" of the entity was a component in setting the credit rating. Standard & Poor's specifically establishes that the "autonomy" of a rate setting entity is important because autonomy insulates the utility "from exposure to political interference that might deter a timely and adequate adjustment" of rates.[70]

The question of what extent the Board of the MassPike is autonomous in setting rates is currently pending before the Supreme Judicial Court.[71] While the SJC deliberates, management uncertainties result in increased costs,[72] and an inability to make budgetary[73] or policy[74] decisions affecting the Western Turnpike or the Metropolitan Highway System.

The SJC will ultimately resolve the MassPike case according to the specific terms of the present legislation,[75] but, in the interim, the continuing uncertainty has created credit concerns. Regardless of the SJC's final decision in the above matter, the Legislature should review and decide what level of autonomy should be imposed upon MassPike and other agencies[76] and authorities of the Commonwealth. The certainty created by comprehensive legislation on the question of autonomy will be viewed in a positive fashion by the rating agencies.

RECOMMENDATION:

Therefore, the Working Group recommends the following:

(1) The Legislature should review and determine what level of autonomy should be imposed upon the Massachusetts Turnpike Authority and other agencies and authorities of the Commonwealth.

VI. SCHOOL BUILDING ASSISTANCE BUREAU (SBAB)

"Larger than the State's General Obligation Debt"

The School Building Assistance Bureau's reimbursement program is considered one of the largest potential "budget busters" by both credit raters and debt managers.

One credit rater told the select committee that municipalities in New Jersey are "dancing in the streets" if they receive as much as 18 percent for school building assistance. In Massachusetts, by comparison, reimbursement ranges from 50 percent to 90 percent for hard construction costs, in addition to some debt service. Even the more affluent municipalities are eligible for as much as 50 percent school building contract assistance.

According to the House Budget Study Group, "SBAB experienced 170% growth since 1992."[77] In FY 1992, SBAB received $134 million, while in FY 2002 the funds were increased to $361 million.[78] A recent report by the Executive Office of Administration and Finance projected that by FY2004, the Commonwealth would be appropriating $450 million annually - almost $200 million more than FY2000 levels. As of today, the Commonwealth's "out-year" obligation for SBA projects stands at nearly $6 billion and is growing. There are 236 capital projects and 46 repairs currently on the waiting list. The Commonwealth's current SBAB commitment combined with the needs on the waiting list amounts to approximately $10.6 billion in out-year commitments.[79] **By FY2005, the Commonwealth will have a greater outstanding obligation for SBA than for its total (2002) General Obligation debt, which supports the statewide capital-spending program.**[80]

The number of SBAB grants awarded each fiscal year is established in the General Appropriations Bill. The municipalities issue the bonds, then the state reimburses a portion of the costs through grants funded out of the state's operating budget, as noted above. The Commonwealth usually begins paying on those projects the following year, and continues to pay a portion toward a municipality's debt for the next 20 years.[81] While grants funded through the operating budget are legally subject to appropriation on an annual basis, the state has a moral obligation to assist municipalities that have already bonded their school capital costs, and bondholders expect the state to fulfill the original commitment.[82]

While the Commonwealth has an obligation to fund projects already on the list, a number of tighter requirements are being implemented based on the SBA reform law passed in 2000. Reforms include prioritizing projects on the list based on need. Moreover, the "2000 SBA reform law put a renewed emphasis on on-going maintenance and repair work, to minimize the need to replace or totally renovate existing buildings."[83]

As an example of the need for program changes, a Department of Education representative testified that a project that in the recent past would have been reimbursed in under four years can now easily wait up to 10 years for reimbursement.[84] As a consequence,

> applicants who intend to begin construction prior to receiving the grant award must be prepared to issue the permanent financing...Applicants must submit, prior to start of construction, a vote of the local appropriating authority (as defined in M.G.L. c.59 s.21C) acknowledging that placement on the waiting list does not guarantee a grant award within any particular time...[85]

Given the current situation it is evident that the program is at a cross-roads.

RECOMMENDATION:

Therefore, the Working Group recommends the following:

(1) The creation of a select task force on the School Building Assistance program. The task force shall review the report and recommendations of A&F's report on "Reconstructing the School Building Assistance Program."

(2) The task force shall issue findings on the feasibility of a capital pooling for school building projects.

VII. Revenue Forecasting

Greater "Sophistication"

The ability of the Legislature to forecast revenues in a greater, more sophisticated and economic sector-based manner will bring greater financial and management stability in future and cyclical economic retractions. Sophisticated revenue forecasting is considered credit positive by the rating agencies. This enhanced forecasting will be a significant change similar to the Legislature's emphasis on a healthy stabilization fund as a "programmatic change that ... contributed to the significant improvement in its financial position since the fiscal crisis of the early 1990's."[86]

The rating agencies stated that the present deficits are related, in part, to the establishment of expenditure levels based upon "unrealistic revenue" expectations.[87] Massachusetts' tax revenues are highly dependent upon revenue derived from personal income taxes.[88] "Because these revenues are based more heavily upon volatile sources such as stock options and capital gains, growth in tax revenues has also been far more subject to wild swings than it would otherwise be. A market downturn that affects relatively few wage earners could turn gains into losses for investors, thus sharply contracting a hitherto rich source of revenue almost overnight."[89]

Between FY 2001 and FY 2002, it is estimated that revenues attributable to stock-related tax receipts fell from $1.6 billion to $682 million, or a drop of $1 billion.[90] Because the only "broad-based, timely, high-quality state level economic indicator" available is the data on non-farm employment issued by the United States Department of Labor's Bureau of Labor Statistics," Massachusetts, like other states, is unable to effectively predict the impact on state revenues of down turns in the stock market[91] or in particularly important sectors of the Massachusetts economy.[92]

In addition, the consensus tax revenue estimates, as presented by the Massachusetts Department of Revenue, are based upon estimates provided by two vendors', Economy.com and DRI/WEFA, economic forecasts.[93] These forecasts are based upon national economic trends with little Massachusetts' based analysis. To the extent that the Massachusetts' economic activity is highly reliant on particular sectors of the economy, it is unclear how much DOR bases its revenue estimates on those Massachusetts sector-based considerations. Standard & Poor's stated that Massachusetts revenue forecasting was "unsophisticated" because DOR was unable to segment, on a present basis, the components of personal income tax receipts that were related to employee bonuses and options on stocks[94] and because it lacked a more sector-based analysis of the Massachusetts economy.

In response to this critique and in order to place the Commonwealth in a more secure position for the next cyclical economic downturn, the Credit Rating Working Group recommends that the following recommendations be adopted.

RECOMMENDATION:

The Working Group recommends the following:

(1) That the Legislature create a Legislative Fiscal Bureau similar to legislative budget offices in other states such as Wisconsin's Fiscal Bureau or on the national level, the Congressional Budget Office. The Bureau will be a non-partisan entity that will assist the House and Senate Committees on Ways & Means with certain functions which shall include (1) estimating state revenues; (2) analyzing and evaluating state programs; (3) monitoring state agencies' budgets and programs; and, (4) evaluating legislative proposals for fiscal effect.

(2) The House & Senate Committees on Ways & Means, the Executive Office of Administration and Finance, and the Department of Revenue jointly conduct a study that will recommend methods or systems that will allow the Department of Revenue and the Legislative Fiscal Bureau to segment and project components of the personal income stream among capital gains, bonuses and stock options. In addition, the above study will also recommend methods or systems that will allow tax revenue estimates to be less reliant on national economic trends and be focused on state economic-sector analysis.

5. Conclusion

In conclusion, the Credit Rating Working Group respectfully reports its findings and recommendations to the House membership for its review, consideration, discussion and deliberation.

[1] The hearing in State House Room B-1 was taped by WGBX-TV (Channel 44) for broadcast.

[2] Presentations: Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002; Moody's Investor Service, Rating Agency Presentation: HPAO Committee Room 146, Wed., 20 February 2002; Fitch Ratings, Rating Agency Presentation: HPAO Committee Room 146, Thurs., 21 February 2002.

[3] Moody's Investor Service, Rating Agency Presentation: HPAO Committee Room 146, February 20, 2002. Materials Distribution, provided to the Credit Rating Working Group.

[4] Id.

[5] Electronic mail response from vice president, Moody's Investor Service to HPAO Bureau Director, 22 March 2002.

[6] See: Materials Distribution, Moody's Investor Service, Rating Agency Presentation: HPAO Committee Room 146, February 20, 2002, pp. 11-12.

[7] Fitch Ratings, materials: "Tax Supported New Issue: Commonwealth of Massachusetts." January 17, 2002. pp. 1-2.

[8] See Materials Distribution, Rating Agency Presentation: February 20, 2002 , p. 21.

[9] See: Moody's Investor Service, Rating Agency Presentation: HPAO Committee Room 146, February 20, 2002. Materials Distribution, p.13.

[10] "State of the States," a report by Standard and Poor's Corporation, 5 March 2001, Standard and Poor's website (www.standardandpoors.com/ratingsdirect)

[11] Select Committee: Credit Rating Working Group, Public Hearing, Tues., 5 March 2002, Gardner Auditorium; Presentations: Standard and Poor's Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002; Moody's Investor Services, Rating Agency Presentation: HPAO Committee Room 146, Wed., 20 February 2002; Fitch Ratings, Rating Agency Presentation: HPAO Committee Room 146, Thurs., 21 February 2002. Office of the State Treasurer, Thurs., 28 February 2002

[12] Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

[13] Fitch Ratings, Credit Rating Panel, Select Committee: Credit Rating Working Group, Public Hearing, Tues., 5 March 2002.

[14] Seminar Presentation: Jeffrey Stearns, deputy treasurer, Office of the State Treasurer and Receiver General, HPAO Committee Room 146, Thurs., 28 February 2002.

[15] Id.

[16] Standard and Poor's Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002.

[17] Testimony of the First Deputy Treasurer, Office of the State Treasurer and Receiver General, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[18] Comments of the Portfolio Manager, Spartan Municipal Income Fund Annual Report, Fidelity Investments.

[19] Public Hearing, Tuesday, 5 March 2002; Presentations: Standard and Poor's Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002; Moody's Investor Services, Rating Agency Presentation: HPAO Committee Room 146, Wed., 20 February 2002; Fitch Ratings, Rating Agency Presentation: HPAO Committee Room 146, Thurs., 21 February 2002.

[20] Moody's Investor Services, Rating Agency Presentation: HPAO Committee Room 146, Wed., 20 February 2002.

[21] Comments of vice president, public finance, Moody's Investor Services, Rating Agency Presentation: HPAO Committee Room 146, Wednesday, 20 February 2002.

[22] "When Lawyers Inhale," The Economist, 20 May 1999; "The Tobacco Deal, " Jeremy Bulow and Paul Klemperer, *Brookings Papers on Economic Activity: Microeconomic*s, 1998, (www.nuff.ox.ac.uk/economics/people/klemperer.htm)

[23] Response via electronic mail by the vice president, public finance, Moody's Investor Service, to HPAO Bureau Director, Friday, 22 March 2002.

[24] Response via electronic mail by vice chairwoman, Fitch Ratings, to HPAO Bureau Director, 14 March 2002.

[25] Response via Electronic Mail by managing director, Boston Office, Standard and Poor's to HPAO Bureau Director, Thursday, 14 March 2002.

[26] "No risk in tobacco-bond sales, Almond aide tells House panel," Providence Journal Bulletin, Thursday, 7 March 2002, p.15.

[27] See: "Discussion of Governor's Tobacco Securitization Proposal," (Wisconsin) Legislative Fiscal Bureau, 22 February 2002, Madison, Wisconsin.

[28] "When Lawyers Inhale," The Economist, 20 May 1999.

[29] "Tobacco Bonds Provide Financing Options," American City and County, 1 May 2001; "Tobacco Bonds: Well-Received San Diego Deal Eases Some Doubts About Sector," Bond Buyer, 17 December 2001.

[30] "Tobacco Bonds Provide Financing Options," American City and County, 1 May 2001; "Tobacco Bonds: Well-Received San Diego Deal Eases Some Doubts About Sector," Bond Buyer, 17 December 2001.

[31] State of the States report, Standard and Poor's Corporation, 5 March 2002, available on the S&P website at (www.standardandpoors.com/ratingsdirect)

[32] "Saved by Smokers," The Economist: The United States, 24 November 2001, p. 33. "And although Tennessee's governor, Don Sundquist, vetoed the legislature's decision to cobble the budget together with tobacco money, it overrode his veto. 'If the legislature had deliberately set out to wreck the state's finances, I doubt it could have done a better job,' Mr. Sundquist lamented."

[33] Presentations: Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002; Moody's Investor Services, Rating Agency Presentation: HPAO Committee Room 146, Wed., 20 February 2002; Fitch Ratings, Rating Agency Presentation: HPAO Committee Room 146, Thurs., 21 February 2002 "Saved by Smokers," The Economist: The United States, 24 November 2001, p. 33; "No risk in tobacco-bond sales, Almond aide tells House panel," Providence Journal Bulletin, Thursday, 7 March 2002, p.15; "Discussion of Governor's Tobacco Securitization Proposal," (Wisconsin) Legislative Fiscal Bureau, 22 February 2002, Madison, Wisconsin.

[34] Fitch Ratings, Rating Agency Presentation: HPAO Committee Room 146, Thursday, 21 February 2002.

[35] Missouri Constitution, Article IV, section 27 (A).

[36] Testimony of the First Deputy Treasurer, Office of the State Treasurer and Receiver General, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[37] G.L. c. 32, §22C.

[38] *Closing the Gap*, Pension Reserve Investment Trust Board, Annual Report of the Pension Reserves Investment Trust Fund for the Fiscal Year ended June 30, 2000, p. 2.

[39] Testimony of the First Deputy Treasurer, Office of the State Treasurer and Receiver General, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[40] Testimony: Credit Rating Panel (Fitch Ratings, Moody's Investor Service, Standard & Poor's) Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[41] Id.

[42] Id.

[43] Id.

[44] Id.

[45] Id.

[46] Testimony of the First Deputy Treasurer, Office of the State Treasurer and Receiver General, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[47] Id.

[48] Id.

[49] Id.

[50] Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

[51] Office of the State Comptroller Presentation: HPAO Committee Room 146, Wed., 27 February 2002.

[52] Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

53 Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

54 Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

55 Presentation: Standard & Poor's HPAO Committee Room 146, 13 February 2002.

56 Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

57 Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2001, Office of the State Comptroller. p.87; Statement of the House Chairman of the Committee on Transportation and co-chairman of the Select House Committee on Credit Rating Working Group(CRWG), Gardner Auditorium, Tues., 5 March 2002.

58 "Latest 'hike' is Only Shift in Accounting," Jack Sullivan, Boston Herald, Boston, Mass, Sat. 9 March 2002, p. 9

59 Report on the October 2001 Finance Plan for the Central Artery/Tunnel Project, Department of Transportation Office of the Inspector General, 11 March 2002.

60 Standard and Poor's Rating Agency Presentation: HPAO Committee Room 146, Wed., 13 February 2002.

61 *Municipal Market Strategist*, UBS Paine Webber, 24 January 2002, p.26.

62 Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 20 March 2002.

63 Testimony: Massachusetts Port Authority Panel, Select House Committee: Credit Rating Working Group Public Hearing, Wednesday, 20 March 2002..

64 Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

65 Presentation: Deputy Treasurer for Debt Management, Office of the Massachusetts Treasurer and Receiver General, HPAO Committee Room 146, February 28, 2002.

66 Presentation: Deputy Treasurer for Debt Management, Office of the Massachusetts Treasurer and Receiver General, HPAO Committee Room 146, February 28, 2002.

67 Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

68 Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

69 MTA debt totals $2 billion for the Metropolitan Highway System and $260 million for the Western Turnpike. The MTA has an additional $380 million in payments for the CA/T project.

70 Standard & Poor's Public Finance Criteria 2000, page 110.

71 Levy, et al v. The Acting Governor of the Commonwealth, et al, Suffolk County, SJC-08730.

72 The Authority has two general counsels and two executive directors pending the SJC decision.

73 The Authority is unable to reach a resolution on the imposition of expense reductions or revenue enhancers to coincide with an increasing debt service.

74 The Authority is unable to make recommendation concerning the re-imposition of tolls on interchanges 1-6 and other interchanges.

75 G.L. c. 81A (2000 ed.)

76 Attached as an Exhibit is a an analysis of the Powers of Appointment, terms of appointment and removal provisions for a representative sample of agencies and authorities.

77 Massachusetts House of Representatives: Budget Study Working Group: Summary for Caucus, March 20, 2002.

78 Massachusetts House of Representatives: Budget Study Working Group: Summary for Caucus, March 20, 2002.

79 Testimony, Director of Finance, Massachusetts Department of Education, Select House Committee: Credit Rating Working Group, Wednesday, March 20, 2002..

80 Reconstructing the School Building Assistance Program, Policy Report Series No. 3 - January, 2000

81 Testimony, Director of Finance, Massachusetts Department of Education, Select House Committee: Credit Rating Working Group, Wednesday, March 20, 2002.

[82] Testimony, Director of Finance, Massachusetts Department of Education, Select House Committee: Credit Rating Working Group, Wednesday, March 20, 2002.

[83] Massachusetts Department of Education. School Building Assistance Program – Administrative Advisory 01-2. March 21, 2002. [On-Line] Available: (http://finance1.doe.mass.edu/sbuilding/admin_adv02_1.html)

[84] Testimony, Director of Finance, Massachusetts Department of Education, Select House Committee: Credit Rating Working Group, Wednesday, March 20, 2002..

[85] Massachusetts Department of Education. School Building Assistance Program – Administrative Advisory 01-2. March 21, 2002. [On-Line] Available: (http://finance1.doe.mass.edu/sbuilding/admin_adv02_1.html)

[87] Testimony: Credit Rating Panel, Select House Committee: Credit Rating Working Group, Tuesday, 5 March 2002.

[88] Testimony: Mass. Department of Revenue, Consensus Revenue Estimate Hearing, Gardner Auditorium, March 6, 2002.

[89] Nicholas W. Jenny, *Severe Decline in State Tax Revenue*, State Revenue Report, Fiscal Studies Program, The Nelson A. Rockefeller Institute of Government, No. 46 (December 2001).

[90] Testimony of Alan Clayton-Matthews, University of Massachusetts/Boston, before the Consensus Revenue Estimate Hearing, March 6, 2002.

[91] Testimony, Undersecretary of Administration and Finance, Select House Committee: Credit Rating Working Group, Wednesday, March 20, 2002.

[92] Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

[93] Testimony: Mass. Department of Revenue, Consensus Revenue Estimate Hearing, Gardner Auditorium, March 6, 2002.

[94] Standard and Poor's, Rating Agency Presentation: HPAO Committee Room 146, 13 February 2002.

EXHIBITS

The Commonwealth of Massachusetts

House of Representatives

State House, Boston 02133-1054

Public Hearing Agenda
Credit Rating Working Group

House Committee on Post Audit and Oversight
House Committee on Transportation
House Committee on Long-Term Debt

Gardner Auditorium, Tuesday, 5 March 2002

10 a.m.-		Opening Remarks Credit Rating Working Group Co-Chairpersons
10:15 –	10: 45 a.m.	Katherine Bradbury – Federal Reserve/ Boston
10:45 –	11:15 a.m.	James Rooney – Boston Convention Center
11:15a.m. –	12:15 p.m	Credit Rating Agency Panel – opening remarks/ dialogue • Fitch Ratings – Claire Cohen, Vice Chairwoman • Moody's Investor Service – Anne Brossard, Vice President • Standard and Poor's – Philip Shapiro, Managing Director
12:15 –	12:45 p.m.	Jeffrey Stearns, Deputy Treasurer/debt finance Office of the State Treasurer and Receiver General
12:45 –	1:15 p.m.	**Break – one half hour**
1:15 –	1:45 p.m.	Office of the Comptroller – slide presentation/dialogue Martin Benison, Comptroller
1:45 –	2:15 p.m.	Massachusetts Turnpike Authority Panel
2:15 –	2:45 p.m.	Massachusetts Port Authority Panel
2:45 –	3:15 p.m.	Laura Guadagno, Assistant Secretary/capital resources Administration and Finance Secretariat
3:15 –	3:45 p.m.	Jeff Wolfson, Department of Education School Building Contract Assistance
3:45 p.m. –		Closing Remarks

The Commonwealth of Massachusetts

House of Representatives

State House, Boston 02133-1054

Public Hearing Agenda
Credit Rating Working Group

House Committee on Post Audit and Oversight
House Committee on Transportation
House Committee on Long-Term Debt

State House Annex, Room B-1, Tuesday, 20 March 2002

10 a.m.-	Opening Remarks Credit Rating Working Group Co-Chairpersons
10: a.m.	Massachusetts Port Authority Panel
10:45 a.m.	Administration and Finance Panel Laura Guadagno, Assistant Secretary/capital resources Executive Office of Administration and Finance
11:30 a.m.	Department of Education School Building Assistance

INDEPENDENT AGENCIES AND AUTHORITIES:

"Powers of Appointment, Terms of Appointment, and Removal Provisions"

Chapter 161A

Massachusetts Bay Transportation Authority

Section 7 Board of Directors

"The authority shall be managed by a board of nine directors, one of whom shall be the secretary who shall serve as chairman of the board and shall not be compensated therefor and eight whom shall be appointed by the governor to two year terms beginning July 1 and who shall be eligible for reappointment." "Any director, except the chairman, may be removed for cause by the governor. In event of a vacancy, a successor shall be named in the same manner as the vacated director and such successor shall serve for the remainder of the unexpired term."

Section 18 Insufficiency of funds; payments by commonwealth

"To the extent that funds paid to the authority pursuant to section 35T of Chapter 10 are insufficient in any year to meet the debt service or other payment obligations of the authority, in connection with debt or other financing obligations of the authority, including, without limitation, leases, reimbursement obligations or interest exchange agreements, issued or entered into prior to July 1, 2000 in respect of which the commonwealth has pledged its credit or is otherwise liable or as to which the authority has covenanted to maintain net cost of service or contract assistance support, the commonwealth shall remain liable for the payment of such obligations or the provision of net cost of service or contract assistance support as to such obligation to the same extent as before the enactment of this chapter; provided, that the amount of any such support provided by the commonwealth to the authority pursuant to this section shall be in the form of a no-interest loan repayable within five years from the dedicated revenue source and system revenues of the authority. Notwithstanding the provisions of this section, the commonwealth may, subject to appropriation and the provisions of article 62 of the Constitution of the Commonwealth, pledge its credit, guaranty, or support for the funding of transit commitment made in connection with the central artery project, so-called, capital improvements required under the Americans With Disabilities Act, or any other projects to conform to federal statutory mandates, or projects or services specifically authorized by the general court after July1, 2000, or any other projects or services authorized by the general court prior to said July 1 for which funding is appropriated by the general court subsequent to said July 1; provided that the authority shall not be obligated to make expenditures for any such commitments or projects so authorized for which the funds necessary to complete and operate such commitments or projects, including the guarantee of contract assistance, have not been made available to the authority. The authority shall undertake such projects and services so authorized and funded and shall incorporate them into the capital investment program established pursuant to paragraph (g) of section 5 and shall not make them subject to the priority ranking established by said paragraph (g) for other projects of the authority."

"If at any time any principal or interest is due or about to come due on any bond or note issued or assumed by the authority prior to July 1, 2000, other than any principal or interest on any bond anticipation note guaranteed by the commonwealth, or any payment is due or about to come due under any other financing obligation undertaken or assumed by the authority prior to July 1, 2000, including without limitation a lease, a reimbursement agreement, or an interest exchange agreement, and funds to pay the same are not available, the directors shall certify to the state treasurer the amount required to meet such obligations, and the commonwealth shall thereupon pay over to the authority the amount so certified. If the commonwealth shall not make such payment within a reasonable time or shall not pay when required under any applicable contact assistance in effect prior to July 1, 2000. The authority or any holder of an unpaid bond or note issued or assumed by the authority as aforesaid, or any obligee in respect of any other such financing obligation, acting in the name and on behalf of the authority as aforesaid, shall have the right to require the commonwealth to pay the authority the amount remaining unpaid, which right shall be enforceable as a claim against the commonwealth. The authority or any such holder or obligee may file a petition in the superior court for Suffolk county to enforce such claim or intervene in any such proceeding already commenced, and the provisions of chapter 258 shall apply to such petition insofar as it relates to the enforcement of a claim against the commonwealth. Any such holder or obligee who shall have filed such a petition may apply funds received by the authority on its claim against the commonwealth to the payment of the petitioner's unpaid obligation, and said court, if it finds such amount to be due to such holder or obligee, shall issue such an order."

Chapter 15C

Massachusetts College Student Loan Authority

Section 2 **Short title "Massachusetts Educational Financing Authority Act"**

Section 4 **Massachusetts educational financing authority; members; terms; meetings; surety bond; conflict of interest.**

"The Authority shall consist of nine members who shall be residents of the commonwealth, not more than five of whom shall be members of the same political party. Seven members shall be appointed by the governor." "The other two members of the authority shall be the director of economic development *ex officio* and the commissioner of administration *ex officio*, or their designees. The members of the authority first appointed shall serve for terms expiring on July 1st in the years 1983, 1984, 1985, 1986, 1987, and 1988, respectively, the term of each such member to be designated by the governor. The term of each ex officio member shall be concurrent with his tenure in that office. Upon the expiration of the term of any originally appointed member his successor shall be appointed for a term of six years. The governor shall fill any vacancy for the remainder of the unexpired term. Any member of the authority may be removed by the governor for misfeasance, malfeasance or willful neglect of duty or other cause after notice and a public hearing unless such notice and hearing shall be expressly waived in writing. Members of the authority may serve for successive terms of office."

(d) "Five members of the authority shall constitute a quorum. The affirmative vote of a majority of all the members of the authority shall be necessary for any action taken by the authority. A vacancy in the membership of the authority shall not impair the right of a quorum to exercise all the rights and perform all the duties of the authority."

Section 12 **Payment of bonds or notes; liability of commonwealth**

"Revenue bonds or notes issued under the provisions of this chapter shall not be deemed to constitute a debt or liability of the commonwealth or of any political subdivision thereof or a pledge of the faith and credit of the commonwealth or of any political subdivision, but shall be payable solely from the funds herein provided therefore from revenues. All such revenue bonds or notes shall contain on the face thereof a statement to the effect neither the commonwealth nor the authority shall be obligated to pay the same or the interest thereon except from revenues of the education loan program or programs or the portion thereof for which they are issued and that neither the faith and credit nor the taxing power of the commonwealth or of any subdivision thereof is pledged to the payment of the principal of or the interest on such bonds or notes. The issuance of revenue bonds or notes under the provisions of this chapter shall not directly or indirectly or contingently obligate the commonwealth or any political subdivision thereof to levy or to pledge any form of taxation whatever therefor or to make any appropriation for their payment."

Chapter 23G

The Massachusetts Development Finance Agency

Section 2 **Creation; directors; officers and employees; termination; trade secrets**

(b) "The Agency shall be governed and its corporate powers exercised by a board of directors consisting of secretary of administration and finance and the director of economic development, or their respective designees, and nine members to be appointed by the governor…." "Each member appointed by the governor shall serve for a term of three years; provided, however, that of the initial appointed members four shall serve a term of two years and five for three years. Any person appointed to fill a vacancy in a like manner and shall serve for only the unexpired term of such member. Any member shall be eligible for reappointment. Any member may be removed from his appointment by the governor for cause."

(c) "Six of the directors shall constitute a quorum and the affirmative vote of a majority of directors present at a duly called meeting where a quorum is present shall be necessary for any action to be taken by the board. Any action required or permitted to be taken at a meeting of the directors may be taken without a meeting if all of the directors consent in writing to such action and such written consents are filled with the records of the minutes of the meetings of the board. Such consents shall be treated for all purposes as a vote at a meeting."

Chapter 81A

The Massachusetts Turnpike Authority And Metropolitan Highway System

Section 2 **Members of authority; offices; quorums; salaries and benefits; indemnity.**

"The authority shall consist of three members to be appointed by the governor who shall be residents of the commonwealth, not more than two of whom shall be of the same political party." "The successor of each member shall be appointed for a term of eight years; provided, however; that any person appointed to fill a vacancy shall serve only for the unexpired term. A member of the authority shall be eligible for reappointment. Prior to entering upon the duties of his office, each member of the authority shall take an oath before the governor to administer the duties of his office faithfully and impartially and a record of such oath shall be filed in the office of the state secretary."

"Two members of the authority shall constitute a quorum and the affirmative vote of two members shall be necessary for any action taken by the authority. No vacancy in the membership of the authority shall impair the right of a quorum to exercise all rights and perform all the duties of the authority."

Section 5 **Issuance of notes or bonds; registration system**

(i) "Notes or bonds issued under the provisions of this chapter shall not constitute a debt of the commonwealth or any political subdivision thereof or a pledge of the faith and credit of the commonwealth or of any such political subdivision but such notes or bonds shall be payable solely from the funds herein provided therefor from turnpike revenues or metropolitan highway system revenues, as applicable. All such notes or bonds shall contain on their face a statement to the effect that neither the commonwealth nor the authority shall pay the same or the interest thereon except from revenues of the turnpike or the metropolitan highway system, as applicable, and that neither the faith and credit nor the taxing power of the commonwealth or of any political subdivision thereof is pledged to the principal of or interest on such notes or bonds."

Chapter 708 of the Acts of 1966

An Act Establishing the Massachusetts Housing Finance Agency

Section 3 **Massachusetts Housing Finance Agency**

"The MHFA shall consist of the commissioner of commerce and development, and the commissioner of corporations and taxation, *ex officiis*, and five persons to be appointed by the governor…." "Each appointive member shall be appointed for a term of seven years, except that in making his initial appointments, the governor shall appoint three members to serve for terms of three, five, and six years respectively, as he may designate. Any person appointed to fill a vacancy shall serve only for the unexpired term. Any member shall be eligible for reappointment."

"Four members of the MHFA shall constitute a quorum and the affirmative vote of four members shall be necessary for any action taken by the MHFA. No vacancy in the membership of the MHFA shall impair the right of a quorum to exercise all the rights and perform all the duties of the MHFA."

Section 9 **Credit Of The Commonwealth or any Subdivision Thereof Not Pledged**

"Bonds and notes issued under the provisions of this act shall not be deemed to constitute a debt of the commonwealth or of any political subdivision thereof or a pledge of the faith and credit of the commonwealth or of any political subdivision, but such bonds and notes shall be payable solely from the proceeds of the mortgage loans made under this act, reserve funds created therefore by the MHFA, and any mortgage insurance contracts pertaining thereto. All such bonds and notes shall contain on the face thereof a statement to the effect that neither the MHFA nor the commonwealth nor any political subdivision thereof shall be obligated to pay the same or the interest thereon except such proceeds, reserve fund or mortgage insurance contracts and that neither the faith and credit nor the taxing power of the commonwealth or any political subdivision thereof is pledged to the payment of the principal of or interest on such bonds."

Appendix To Chapter 92

Massachusetts Water Resources Authority Act

Section 1-3 **Massachusetts Water Resources Authority; creation; board of directors**

(a) "There is hereby created and placed in the executive office of environmental affairs a body politic and corporate and a public instrumentality to be known as the Massachusetts Water Resources Authority, which shall be an independent public authority not subject to the supervision or control of the executive office of environmental affairs or of any other executive office, department, commission, board, bureau, agency or political subdivision of the commonwealth except to the extent and in the manner provided in this act. The exercise by the Authority of the powers conferred by this act shall be deemed to be the performance of an essential public function."

(b)"...board of directors consisting of eleven members. One member of the board of directors shall be the secretary of the executive office of environmental affairs, serving *ex officio*, one member of the board of directors who is a resident of a Connecticut river basin community who represents water resources protection interests shall be appointed by the governor and shall serve coterminous with the governor, one member of the board of directors who is a resident of a Merrimack river basin community who represents water resources protection interests shall be appointed by the governor and shall serve coterminous with the governor, one member of the bored of directors shall be appointed by the governor upon the recommendation of the mayor of Quincy in accordance with the procedure set forth in paragraph (c) and shall serve a term of four years, one member of the board of directors shall be appointed by the governor upon the recommendation of the board of selectmen of the town of Winthrop by majority vote, in accordance with the procedure set forth in paragraph (c) shall serve a term of four years; provided however that one of the previous named five members shall be a minority person; three members of the board of directors shall be appointed by the mayor of the city of Boston and shall serve coterminous with the mayor, and three members of the board of directors shall be appointed by the advisory board as provided in section twenty-three of this act. "All persons appointed by the advisory board, including members initially appointed, shall be appointed to terms of three years with one term to expire in each year..." "All persons appointed, including terms of members initially appointed by the advisory board, shall be appointed to terms of two years..."

(d) "Each member of the board of directors shall serve until his successor is appointed and qualified and each appointed member of the board of directors shall be eligible for reappointment. Each member of the board of directors appointed to fill a vacancy on the board shall be appointed for the unexpired term of the vacant position. Each member of the board of directors before entering upon his duties shall take an oath before the governor to administer the duties of office faithfully and impartially and a record of such oaths shall be filed in the office of the secretary of the commonwealth. Any member of the board of directors may be removed by the appointing authority for misfeasance, malfeasance, or willful neglect of duty upon the filing by the appointing authority with the secretary of the commonwealth of a statement of facts and circumstances which form the basis for such removal." "Six members of the board of directors shall constitute a quorum and the affirmative vote of six members shall be necessary and shall suffice for any action taken by the board of directors." "No vacancy in the membership of the board of directors shall impair the right of a quorum to exercise the powers of the board of directors."

Section 1-16 **Bonds not debt or pledge of commonwealth**

"Bonds issued under the provisions of this act, excepting any notes or bonds guaranteed or issued by the commonwealth under paragraphs (e) or (f), respectively, of section five, shall not be deemed to be a debt or pledge of the faith and credit of the commonwealth or of any of its political subdivisions, but shall be payable solely from the funds of the Authority from which they are made pursuant to this act. Bonds issued under the provisions of this act, excepting any notes or bonds guaranteed or issued by the commonwealth under paragraphs (e) or (f) of section five, shall recite that neither the commonwealth nor any political subdivision thereof shall be obligated to pay the same and that neither the faith and credit nor the taxing power of the commonwealth or of any political subdivision thereof is pledged to the payment of the principal of or interest on such bonds. Further, every bond shall recite whether it is a general obligation of the Authority or a special obligation thereof payable solely from particular revenues or funds pledged to its payment. The aggregate principal amount of all bonds issued under the authority of this act shall not exceed the sum of $4,370,000,000 outstanding at any one time; provided, however, that bonds for the payment of redemption of which, either at or prior to maturity, refunding bonds shall have been issued shall be excluded in the computation of outstanding bonds."

Chapter 465 of the Acts of 1956

An Act Providing For the Construction Of An Additional Vehicular Crossing Between Boston Proper And East Boston; Creating The Massachusetts Port Authority And Defining Its Powers And Duties; Providing For the Issuance Of Revenue Bonds Of The Authority, Payable Solely From Tolls And Other Revenues, For Financing Such Additional Crossing, Refinancing The Existing Tunnel And The Mystic River Bridge And Refinancing And Improving The State-Owned Airports And Port Of Boston Facilities; And Providing For The Transfer To Said Authority Of Said Existing Tunnel, Bridge, Airports And Port Facilities.

Section 2 **Massachusetts Port Authority**

"There is hereby created and placed in the department of public works a body politic and corporate to be known as the Massachusetts Port Authority, which shall not be subject to the supervision or regulation of the department of public works or of any department, commission, board, bureau or agency or the commonwealth except to the extent and in the manner provided in this act."

"The Authority shall consist of seven members all of whom shall be appointed by the governor by and with the consent of the council, and shall be residents of the Commonwealth." "The members of the Authority first appointed shall continue in office for terms expiring on June 30th 1960, 1961, 1962, 1963, 1964, 1965, 1966, respectively, the term of each such member to be designated by the governor and to continue until his successor shall be duly appointed and qualified. The successor of each such member shall be appointed for a term of seven years and until his successor shall be duly appointed and qualified except that any person appointed to fill a vacancy shall serve only for the unexpired term. Any member of the Authority shall be eligible for reappointment. Each member of the Authority may be removed by the governor with the advice and consent of the council, for misfeasance, malfeasance or willful neglect of duty but only after reasonable notice and a public hearing unless the same are in writing expressly waived."

"Four members of the Authority shall constitute a quorum and the affirmative vote of four members shall be necessary for any action taken by the Authority. No vacancy in the membership of the Authority shall impair the right of a quorum to exercise all the rights and perform all the duties of the Authority."